84-901

No. ———

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM 1984

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AVCO FINANCIAL SERVICES, INC.,
Petitioner,

v.

CLEVESTER DAVIS, JIMMIE LEE KING, and VIRGINIA KING,
Respondents.

———

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

———

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QUESTION PRESENTED

Whether a person who has not sold a security may be liable for the sale of that security under § 12 (2) of the Securities Act of 1933?

LISTING OF PARTIES

The only petitioner is Avco Financial Services, Inc., which is a wholly-owned subsidiary of Paul Revere Corporation which, in turn, is a wholly-owned subsidiary of Avco Corporation. All other corporations affiliated with petitioner are either directly or indirectly wholly-owned subsidiaries of Avco Corporation.

Respondents are Clevester Davis, Jimmie Lee King, and Virginia Ann King. They sued on behalf of themselves and as representatives of a class, which was certified, of 41 other individuals.

Lee McCormick was a separately named defendant with Petitioner. No judgment was entered against him in the District Court, and he did not appeal to nor was he a party to the proceedings before the Sixth Circuit. Petitioner believes that Lee McCormick has no interest in this petition.

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IN THE

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OCTOBER TERM 1984

No. ———

AVCO FINANCIAL SERVICES, INC.,

Petitioner,

v.

CLEVESTER DAVIS, JIMMIE LEE KING, and VIRGINIA KING,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

Petitioner respectfully prays that a writ of certiorari issue to review the order and opinion of the United States Court of Appeals for the Sixth Circuit entered in this proceeding on July 10, 1984.

OPINIONS BELOW

The opinion of the Court of Appeals for the Sixth Circuit, entered on July 10, 1984, is reported at 739 F.2d 1057 and appears in Appendix A hereto. The findings of fact and conclusions of law of the United States District Court for the Northern District of Ohio, Western Division, in this proceeding are unreported and appear in Appendix B hereto.

STATEMENT OF JURISDICTION

The judgment of the Court of Appeals was entered on July 10, 1984. Timely cross-petitions for rehearing and suggestions of rehearing *en banc* were denied on September 7, 1984. The order denying the petitions appears in Appendix C hereto. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254 (1).

STATUTORY PROVISION INVOLVED

The statutory provision involved is Section 12 (2) of the Securities Act of 1933, 15 U.S.C. § 77*l* (2). Section 12 states:

> Any person who —
>
> (1) offers or sells a security in violation of section 77e of this title, or
>
> (2) offers or sells a security (whether or not exempted by the provisions of section 77c of this title, other than paragraph (2) of subsection (a) of said section), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission,
>
> shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the

consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

STATEMENT OF THE CASE

The Facts And The Claims

This action was instituted and tried in the United States District Court for the Northern District of Ohio, Western Division. Subject matter jurisdiction was asserted and existed under § 27 of the Securities Exchange Act of 1934, 15 U.S.C. § 78aa, and § 22 of the Securities Act of 1933, 15 U.S.C. § 77v.

Respondents brought this case individually and as a class action on behalf of all persons who had borrowed money from petitioner at one of its Toledo, Ohio offices and then used that money to purchase "adventures" from an entity named Dare To Be Great, Inc. (hereinafter "DTBG").[1] The defendants were petitioner and Lee McCormick, who was the manager of petitioner's Toledo, Ohio office where respondents borrowed the money to purchase the "adventures." Respondents did not sue DTBG — the seller of the "adventures" — and it was not a party to this proceeding.

DTBG marketed its "adventures" with all the hoopla of an old time revival meeting and represented to respondents and other potential investors that they could expect substantial returns upon their purchases of DTBG "adventures." DTBG was operating a pyramid scheme and ultimately collapsed along with the pyramid. Respondents,

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[1] The class was certified and consisted of 44 members including respondents.

who purchased "adventures" from DTBG, lost their investments or substantial portions of them.

To buy the "adventures" from DTBG, respondents borrowed the entire purchase price from petitioner at one of its Toledo, Ohio offices. Lee McCormick was petitioner's manager at that location and approved many of the loans to respondents. He knew that respondents would use the loan proceeds to purchase "adventures" from DTBG and also announced at some of DTBG's "sales meetings" that petitioner would loan money for the purpose of buying "adventures" from DTBG.

In consideration for the loans petitioner made to them, respondents executed and delivered promissory notes made payable to petitioner for the full amount of the loans plus interest. A substantial portion of the loans was repaid.

In this case, respondents sought a judgment for the total amount paid to petitioner under the promissory notes and a cancellation of whatever sums may have been still due and owing. They claimed they were entitled to this relief against petitioner because, among other things:

1. The promissory notes were securities and petitioner purchased them from respondents in violation of the anti-fraud provisions of § 10 (b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder;

2. The "adventures" were securities and, in connection with respondents' purchases of them from DTBG, petitioner violated the anti-fraud provisions of § 10 (b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder; and

3. The "adventures" were securities and petitioner sold them to respondents in violation of § 12(2) of the Securities Act of 1933.

The Proceedings Below

Trial was to the court without a jury with the Honorable Nicholas J. Walinski presiding. The District Court found that the promissory notes and "adventures" were securities for the purposes of the federal securities laws and also appeared to find and conclude that petitioner purchased the notes from respondents in violation of § 10 (b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder [32a-33a].[2] The District Court made no finding or conclusion of scienter, i.e., that petitioner acted with an intention to deceive or defraud respondents. Judgment was entered against petitioner for the full amounts paid on the promissory notes plus interest and attorneys' fees [33a-34a].

On appeal, the Sixth Circuit reversed the judgment of the District Court and unanimously held (1) that the promissory notes were not securities for the purposes of the federal securities laws, (2) that the "adventures" were securities, (3) that neither petitioner nor its manager, Lee McCormick, had acted with scienter, and (4) that petitioner, therefore, could not be and was not liable to respondents under Rule 10b-5 in connection with the latters' purchases of "adventures" from DTBG.

The unanimity ended there. With Chief Judge Lively dissenting, the two member majority held that petitioner was liable to respondents under § 12 (2) of the Securities Act of 1933 as a "seller" of the "adventures" and remanded for further proceedings consistent with the opinion.

In an opinion authored by the Honorable William O. Bertelsman, United States District Judge from the Eastern

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[2] All references are to the Appendices to this Petition.

District of Kentucky, joined by Circuit Judge Jones, the majority observed that it was confronted wih a case of first impression in the Sixth Circuit – namely, whether a person who is not a "seller" of securities can be liable for their sale under § 12 (2) of the Securities Act of 1933 [2a]. It then went on to state:

> If we are limited to a literal reading of the statute, it is obvious that the plaintiffs here must fail, because Avco was not in the literal sense the "seller" of DTBG securities [12a].

After making this observation and then neither citing nor relying upon any legislative history, the majority concluded that it was not limited or bound by the literal and plain words of § 12 (2). Rather, it determined that any person who was a "substantial factor" in a plaintiff's decision to purchase a security and whose conduct was negligent is liable under § 12 (2) of the Securities Act of 1933.

In his dissent, Chief Judge Lively noted that the majority's opinion was in conflict with a decision of the Third Circuit and further was contrary to recent holdings of this Court that the federal securities laws do not extend beyond the intention of Congress as expressed in the language of the statutes themselves. He also observed that, by imposing "secondary liability" on the basis of negligence, the majority was countenancing an evasion of this Court's scienter requirement in secondary liability or "indirect participant" settings.

REASONS WHY THE WRIT SHOULD BE GRANTED

Petitioner submits that there are three basic reasons why the writ should be granted. *First,* there is a direct and irreconcilable conflict between the Circuits on the scope of § 12 (2) of the Securities Act of 1933. *Second,* there is a direct and irreconcilable conflict between the decisions of the Sixth Circuit majority and of the Supreme Court on the interpretation of the federal securities laws. *Third,* the decisions of the lower courts on the scope of § 12 (2) of the Securities Act of 1933 are in hopeless confusion and conflict mandating settlement of the question by the Supreme Court.

I. There Is A Direct And Irreconcilable Conflict Between The Sixth Circuit Majority And The Third Circuit On The Scope of § 12(2) Of The Securities Act Of 1933

In pertinent part, § 12 (2) of the Securities Act of 1933, 15 U.S.C. § 77*l* (2), provides that any person who "offers or sells a security" through misrepresentation or omission of material facts "shall be liable to the person purchasing such security from him . . . ." The question presented by this petition is: Whether a person who has not sold a security may be liable for the sale of that security under § 12 (2) of the Securities Act of 1933?

In *Collins* v. *Signetics Corp.,* 605 F.2d 110 (3rd Cir. 1979), a panel of the Third Circuit addressed this question and unanimously answered it in the negative. The court held:

> We have no difficulty in concluding that Congress intended the unambiguous language of of § 12 (2) to

> mean exactly what it says: "Any person who — . . . (2) offers or sells a security . . . shall be liable to the person purchasing from him. . ." This section is designed as a vehicle for a purchaser to claim against his immediate seller. Any broader interpretation would not only torture the plain meaning of the statutory language but would also frustrate the statutory schema [sic] . . .
>
> * * * *
>
> Ascertainment of congressional intent with respect to the standard of liability created by a particular section of the securities acts must "rest primarily on the language of that section." *Ernst* & *Ernst* v. *Hochfelder,* 425 U.S. 185, 200, 96 S. Ct. 1375, 1384, 47 L. Ed. 2d 668 (1976). In interpreting liability provisions of the acts, we must respect recent Supreme Court teachings that militate against excessively expansive readings. [Citing *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723 (1975), *Piper* v. *Chris-Craft Industries, Inc.,* 430 U.S. 1 (1977), *Santa Fe Industries, Inc.* v. *Green,* 430 U.S. 462 (1977), *International Brotherhood of Teamsters* v. *Daniel,* 439 U.S. 551 (1979)]. (605 F.2d at p. 113).

Accord Sanders v. *John Nuveen* & *Co.,* 619 F.2d 1222, 1226 (7th Cir.), *cert. den.,* 450 U. S. 1005 (1981) (dictum). *See also Kennedy* v. *Nicastro,* 503 F.Supp. 1116, 1118 (N.D. Ill. 1980); *Barlas* v. *Bear, Stearn* & *Co.,* [1964-66 Transfer Binder] Fed. Sec. L. Rep. ¶ 91, 674 (N.D. Ill. 1966); *Kramer* v. *Scientific Control Corp.,* 452 F.Supp. 812, 814-15 (E.D. Pa. 1978); *Dorfman* v. *First Boston Corp.,* 336 F. Supp. 1089, 1092-93 (E.D. Pa. 1972).

Tacitly recognizing that its decision conflicted with that of the Third Circuit [13a], the Sixth Circuit majority answered the question presented here affirmatively. In doing so, it emphatically and correctly observed that its holding was not supported by "a literal reading of" § 12 (2)

and that such a reading would have resulted in no liability for petitioner [12a].

Nothing more needs to be said. The conflict here is direct and irreconcilable. A unanimous panel of the Third Circuit has held that § 12 (2) means what it says, and a divided panel of the Sixth Circuit has held that it does not.

II. There Is A Direct And Irreconcilable Conflict Between The Decision Of The Sixth Circuit Majority And The Decisions Of This Court On The Interpretation Of The Federal Securities Laws

The Sixth Circuit majority admittedly applied § 12 (2) of the Securities Act of 1933 in direct defiance of that statute's plain and literal language [12a]. This action was a clear contravention of this Court's repeated holdings that the federal securities laws are to be interpreted in accordance with the manifest intention of Congress as that intention is expressed in the plain words of the statutes and their legislative history. *See Aaron* v. *SEC,* 446 U. S. 680 (1980); *Touche Ross* & *Co.* v. *Redington,* 442 U.S. 560 (1979); *SEC* v. *Sloan,* 436 U.S. 103 (1978); *Piper* v. *Chris-Craft Industries, Inc.,* 430 U.S. 1 (1977); *Ernst* & *Ernst* v. *Hochfelder,* 425 U.S. 185 (1976).

The Sixth Circuit majority relied on *neither* the language of § 12 (2) *nor* its legislative history. Rather, it based its holding upon "the remedial purpose of the securities laws . . . ." [13a].

This Court has expressly held that the "remedial purposes" of the federal securities laws "will not justify reading a provision more broadly than its language and the statutory scheme reasonably permit," *Touche Ross* & *Co.*

v. *Redington,* 442 U.S. at 578, *SEC* v. *Sloan,* 436 U.S. at 116, and that "if the language of a provision of the securities laws is sufficiently clear in its context and not at odds with the legislative history, it is unnecessary 'to examine the additional considerations of policy . . . that may have influenced the lawmakers in their formulation of the statute' ". *Aaron* v. *SEC,* 446 U.S. at 695 (citing *Ernst* & *Ernst* v. *Hochfelder,* 425 U.S. at 214 n. 33.).

Neither the language of § 12 (2), its legislative history, nor the statutory scheme permitted the majority's holding. Indeed, no mention of these points can be found in its decision.

In *Ernst* & *Ernst* v. *Hochfelder,* 425 U.S. at 199 n.19, this Court cited *Addison* v. *Holly Hill Fruit Products, Inc.,* 322 U. S. 607, 618 (1944), with approval and applicable to the federal securities laws:

> After all, legislation when not expressed in technical terms is addressed to the common run of men and is therefore to be understood according to the sense of the thing, as the ordinary man has a right to rely on ordinary words addressed to him.

The "ordinary words" of § 12 (2) are:

> Any person who offers or sells a security . . . shall be liable to the person purchasing the security from him, who may . . . recover the consideration paid for such security . . . upon the tender of such security, or for damages if he no longer owns the security.

These "ordinary words," as the Sixth Circuit majority expressly recognized, mean what they say [12a]. By its terms, § 12 (2) is applicable only to a "seller" of a security and not to someone like petitioner who, as the Sixth Circuit majority again explicitly observed, was not [12a].

Noticeably, the Sixth Circuit majority cited no legislative history in support of its holding. There is none.

Finally, there is no support for the decision under the overall legislative scheme. Congress considered § 12 of the Securities Act of 1933 as one with § 11, 15 U.S.C. § 77k. *See* H.R. Rep. No. 85, 73 Cong., 1st Sess. 9. The latter imposes liability for misleading registration statements only upon specific parties such as signatories, § 11 (a) (1); directors, § 11 (a) (2); underwriters, § 11 (a) (5); and certain experts, § 11 (a) (4). Congress continued this particularized approach in § 12 by imposing liability upon sellers.

When it wanted to extend liability to persons beyond those specifically mentioned in §§ 11 and 12, Congress explicitly did so. Under § 15 of the Securities Act of 1933, 15 U.S.C. § 77o, the liabilities created by §§ 11 and 12 were specifically extended to "control persons." In *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 734 (1975), this Court observed that, when Congress wished to establish liability on a person connected with a security transaction, it has had little difficulty in doing so expressly. That principle applies here. Congress, in § 15 of the Securities Act of 1933, explicitly and unambiguously manifested its intention as to who — in addition to actual sellers — should be liable under § 12. Obviously, that does not include persons in the position of petitioner.[3]

It is well-settled that "[t]he 1933 and 1934 Acts constitute inter-related components of the federal regulatory scheme governing transactions in securities." *Herman* & *MacLean* v. *Huddleston*, 459 U.S. 375, 380 (1983); *Ernst* & *Ernst* v. *Hochfelder*, 425 U.S. at 206. *See also Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. at 727-30.

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[3] There was never even a contention in the proceedings below that petitioner "controlled" or was a "controlling person" of DTBG.

In both *Ernst* & *Ernst* and *Herman* & *MacLean,* this Court observed that, while §§ 11, 12, and 15 of the Securities Act of 1933 were particularized in their scope, § 10 (b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j (b), was much more general in its application. Indeed, in both *Herman* & *MacLean,* 459 U.S. at 382, and *Chiarella* v. *United States,* 445 U.S. 222, 234-35 (1980), this Court noted that § 10 (b) of the Securities Exchange Act of 1934 was a "catch-all" anti-fraud provision applicable to "any person."

In *Ernst* & *Ernst* this Court held that Congress intended that liability for the narrow class of persons specifically mentioned in §§ 11 and 12 of the Securities Act of 1933 be determined on the basis of negligence while liability for the much broader category of "any person" mentioned in § 10 (b) of the Securities Exchange Act of 1934 be judged on the basis of scienter. *Ernst* & *Ernst,* 425 U.S. at 206-211. As Chief Judge Lively noted in his dissent, the Sixth Circuit majority has reversed this principle [27a]. It expressly determined that petitioner could not be liable under § 10 (b) of the Securities Exchange Act of 1934 because of the absence of scienter [10a-11a], that petitioner was not "in the literal sense" the seller of the "adventures" under § 12 (2) of the Securities Act of 1933 [12a], but that petitioner was, nevertheless, "secondarily liable" for DTBG's sale of them under a theory of negligence [20a]. This holding, as Chief Judge Lively pointed out, is contrary to this Court's teaching in *Ernst* & *Ernst.*

In short, the decision of the Sixth Circuit majority is in direct conflict with the holdings of this Court on the important national issue of the interpretation and scope of the federal securities laws.

III. Confusion And Uncertainty Among The Lower Courts On The Scope Of § 12(2) Of The Securities Act of 1933 Requires Settlement Of The Question By This Court

The writ should issue to establish a uniform rule for the application of § 12 (2) of the Securities Act of 1933. The conflict between the Third Circuit and the Sixth Circuit majority only reflects a larger problem.

The majority opinion noted that "[d]etermining secondary liability has long been a thorny problem in implementing the securities laws" and that the courts have given a "variety of interpretations" to the scope of § 12 (2) of the Securities Act of 1933 [10a-11a]. The majority also seemed chagrined that this Court has not addressed the question [13a]. Recently, a significant body of scholarly comment has addressed the conflicting and divergent decisions of the lower courts on the scope of § 12 (2) of the Securities Act of 1933. *See* Rapp, *Expanded Liability Under Section 12 of the Securities Act of 1933: When Is A Seller Not A Seller?*, 27 Case W. Res. L.Rev. 445 (1977); Kaminsky, *An Analysis Of Securities Litigation Under Section 12(2) And How It Compares With Rule 10b-5*, 13 Hous. L. Rev. 231 (1976); O'Hara, *Erosion of the Privity Requirement Of Section 12(2) Of The Securities Act of 1933: The Expanded Meaning Of Seller*, 31 U.C.L.A. L. Rev. 921 (1984); Comment, *Secondary Liability Under Section 12(2) of the Securities Act of 1933*, 78 Nw. L.Rev. 832 (1983); Note, *Seller Liability Under Section 12(2) of the Securities Act of 1933: A Proximate Cause — Substantial Factor Approach Limited By A Duty of Inquiry*, 36 Vand. L. Rev. 361 (1983).

One line of cases holds that non-sellers can be liable under §12 (2) if they actively participated with the seller in

a fraudulent sale either as an aider and abettor or as a co-conspirator. *See deBruin* v. *Andromeda Broadcasting Systems, Inc.*, 465 F.Supp. 1276, 1280 (D. Nev. 1979); *Sommerville* v. *Major Exploration, Inc.*, 576 F.Supp. 902, 913 (S.D. N.Y. 1983); *Lorber* v. *Beebe*, 407 F. Supp. 279, 287-88 (S.D. N.Y. 1975); *Frankel* v. *Wylie & Thornhill, Inc.*, 537 F. Supp. 730, 744 (W.D.. Va. 1982); *Stern* v. *American Bankshares Corp.*, 429 F. Supp. 818, 824 (E.D. Wis. 1977). Under this theory the non-seller must know that a fraudulent scheme is afoot and knowingly and actively participate in it.

Other courts have specifically rejected the application of aiding and abetting and co-conspirator theories under § 12 (2). *See Croy* v. *Campbell*, 624 F.2d 709, 713 n.5 (5th Cir. 1980); *Briggs* v. *Sterner*, 529 F. Supp. 1155, 1173 (S.D. Iowa 1981); *Haggert* v. *Glickman, Lurie, Eiger & Co.*, 520 F.Supp. 1028, 1034 (D. Minn. 1981).

Some courts have imposed § 12 (2) liability upon non-sellers where they were the "substantial factors" in the plaintiffs' decision to purchase securities *and* either made the false or misleading statements which formed the basis of the § 12 (2) violation, "controlled" the seller, or fostered, generated, or caused the making of the false or misleading statement. *See Hill York Corp.* v. *American International Franchises, Inc.*, 448 F.2d 680 (5th Cir. 1971); *Junker* v. *Crory*, 650 F.2d 1349 (5th Cir. 1981); *SEC* v. *Murphy*, 626 F.2d 633 (9th Cir. 1980); *Lennerth* v. *Mendenhall*, 234 F. Supp. 59 (N.D. Ohio 1964).

The Ninth Circuit, while employing the so-called "substantial factor" test, has questioned whether it is valid in light of this Court's recent decisions. *See Admiralty Fund* v. *Jones*, 677 F. 2d 1289, 1294 & n.3 (9th Cir. 1982). One of its later decisions suggests that it has abandoned that test

altogether. *See Feldman* v. *Simkins Industries, Inc.*, 679 F.2d 1299, 1306 (9th Cir. 1982). The Eighth Circuit has specifically criticized the "substantial factor" test in imposing § 12 (2) liability. *See Wasson* v. *SEC*, 558 F.2d 879, 886 (8th Cir. 1977).

Finally, there is that line of cases discussed earlier in this petition which, in determining the scope of § 12 (2), do not use tort, conspiracy, or other "secondary liability" type theories. Rather, these courts apply § 12 (2) by its terms — only to actual sellers of securities. *See Collins* v. *Signetics Corp.*, 605 F.2d at 113; *Sanders* v. *John Nuveen & Co.*, 619 F.2d at 1226 (dictum); *Kennedy* v. *Nicastro*, 503 F.Supp. at 1118; *Barlas* v. *Bear, Stern & Co.*, [1964-66 Transfer Binder] Fed. Sec. L. Rep. ¶ 91, 674; *Kramer* v. *Scientific Control Corp.*, 452 F.Supp. at 814-15; *Dorfman* v. *First Boston Corp.*, 336 F.Supp. at 1092-93.

In short, there is no uniform rule regarding the scope of this important federal statute. The applicable law is not dependent upon the terms of a statute which is nationwide in scope, but upon the law as it may be at any given point in time in any particular Circuit or District. Petitioner respectfully submits that this Court should eliminate these variations and contradictions by issuing the writ in this case.

CONCLUSION

For the foregoing reasons, a writ of certiorari should issue to the United States Court of Appeals for the Sixth Circuit.

Respectfully submitted,

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APPENDIX A

UNITED STATES COURT OF APPEALS,
SIXTH CIRCUIT

Nos. 82-3553, 82-3572

CLEVESTER DAVIS, JIMMIE LEE KING,
and VIRGINIA ANN KING,

Plaintiff-Appellees,
Cross-Appellants,

v.

AVCO FINANCIAL SERVICES, INC.,

Defendant-Appellant,
Cross-Appellee,

Lee McCormick, Defendant

Argued February 2, 1984

Decided July 10, 1984

Before LIVELY, Chief Judge, JONES, Circuit Judge, and BERTELSMAN, District Judge.*

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* Hon. William O. Bertelsman, Judge, United States District Court for the Eastern District of Kentucky, sitting by designation.

BERTELSMAN, District Judge.

This securities case presents this court with an issue of first impression in this circuit, namely, who may be considered a "seller" under § 12 (2) of the Securities Act of 1933. Other circuits have expressed diverse views regarding this issue, as have the commentators. The Supreme Court of the United States has never passed on it. Various subsidiary issues are also presented, as will be discussed below.

FACTS

This is a securities fraud class action arising out of the activities of defendants/appellants AVCO Financial Services, Inc. and defendant McCormick, the manager of Avco's Toledo, Ohio office. The plaintiffs/appellees all borrowed money from Avco in order to buy shares of a scheme called "Dare to be Great" (DTBG). DTBG was a pyramidal scheme wherein investors could buy "adventures" at Levels I, II, III or IV. Purchases of adventures Levels III (price: $2,000) and IV (price: $,5000) gave the purchasers the right to sell adventures to other purchasers, and collect a commissin (sic) thereon.

The sales of DTBG were based on hardsell tactics and promises of quick wealth by salespeople who flaunted money and expensive cars, clothing, jewelry, and the like. Because of its inherent "saturation" character, this scheme was apparently doomed to fail, and did so in 1974, causing members of the plaintiff class to lose nearly all of the money they had invested in it. DTBG marketing techniques are described in detail in *S.E.C.* v. *Glenn W. Turner Enterprises, Inc.*, 474 F.2d 476 (9th Cir.), *cert. denied,* 414 U.S. 821, 94 S.Ct. 117, 38 L.Ed.2d 53 (1973). The evidence in this case is the same as the evidence described in the Ninth

Circuit case. The operation of the DTBG enterprise was described therein as follows:

> "II. The Adventures and the Plan in operation.
>
> "It is apparent from the record that what is sold is not of the usual 'business motivation' type of courses. Rather, the purchaser is really buying the possibility of deriving money from the sale of the plans by Dare to individuals whom the purchaser has brought to Dare. The promotional aspects of the plan, such as seminars, films, and records, are aimed at interesting others in the Plans. Their value for any other purpose, is, to put it mildly, minimal.
>
> "Once an individual has purchased a Plan, he turns his efforts toward bringing others into the organization, for which he will receive a part of what they pay. His task is to bring prospective purchasers to 'Adventure Meetings.'
>
> "A. The meetings.
>
> "These meetings are like an old time revival meeting, but directed toward the joys of making easy money rather than salvation. Their purpose is to convince prospective purchasers, or 'prospects', that Dare is a sure route to great riches. At the meetings are employees, officers, and speakers from Dare, as well as purchasers (now 'salesmen') and their prospects. The Dare people, not the purchaser-'salesmen', run the meetings and do the selling. They exude great enthusiasm, cheering and chanting; there is exuberant handshaking, standing on chairs, shouting, and 'money-humming'. The Dare people dress in expensive, modern clothes; they display large sums of cash, flaunting it to those present, and even at times throwing it about; they drive new and expensive automobiles, which are conspicuously parked in large numbers outside the meeting place. Dare speakers describe, usually in a frenzied manner, the wealth that

awaits the prospects if they will purchase one of the plans. Films are shown, usually involving the 'rags-to-riches' story of Dare founder Glenn W. Turner. The goal of all of this is to persuade the prospect to purchase a plan, especially Adventure IV, so that he may become a 'salesman', and thus grow wealthy as part of the Dare organization. It is intimated that as Glenn W. Turner Enterprises, Inc. expands, high positions in the organization, as well as lucrative opportunities to purchase stock, will be available. After the meeting, pressure is applied to the prospect by Dare people, in an effort to induce him to purchase one of the Adventures of the plan. The sale is sometimes closed by the purchaser who brought the prospect to the meeting, but primarily, by Dare salesmen, specialists in the 'hard sell.'

"The format of the meeting is preordained. A script created by Dare is strictly adhered to. The format applies even to the sale, there being a standard procedure for inducing the prospect to sign his name to the agreement and to part with his money. While no express guarantee of success is made at the meetings, and the statement is made that the purchaser must expect to work, the impression which is fostered is of the near inevitability of success to be achieved by anyone who purchases a plan and follows Dare's instructions.

"Dare also arranges, in addition to the Adventure Meetings, 'GO Tours,' or 'Golden Opportunity Tours.' Prospects are taken by plane or bus to one of Dare's regional centers where further meetings and sales efforts are undertaken. A significant effort is made during the trip itself to sell the plans to prospects. Much the same atmosphere as at the meetings pervades the trip – exuberant shouting, chanting, handshaking, relating of success stories, and lavish displays of cash.

"In a scheme such as this, the possibility that a mar-

ket will became 'saturated' is a real one. Saturation has in fact occurred in some markets, but this is not mentioned at the meetings. Few, if any, purchasers of these plans have achieved any success remotely approaching that described by defendants and their agents.

"B. The role of the purchaser-salesman.

"Once he has bought a plan that empowers him to help sell the plans to others, the task of the purchaser is to find prospects and induce them to attend Adventure Meetings. He is not to tell them that Dare To Be Great, Inc. is involved. Rather, he catches their interest by intimating that the result of attendance will be significant wealth for the prospect. It is at the meetings that the sales effort takes place. The 'salesman' is also told that to maximize his chances of success he should impart an aura of affluence, whether spurious or not — to pretend that through his association with Dare he has obtained wealth of no small proportions. The training that he has received at Dare is aimed at educating him on this point. He is told to 'fake it 'til you make it,' or to give the impression of wealth even if it has not been attained. He is urged to go into debt if necessary to purchase a new and expensive automobile and flashy clothes, and to carry with him large sums of money, borrowing if necessary, so that it can be ostentatiously displayed. The purpose of all this is to put the prospect in a more receptive state of mind with respect to the inducements that he will be subject to at the meetings."

Id. 474 F.2d at 478-80.

From about February to July, 1971, Avco provided loans, secured by promissory notes, to persons who wanted to invest in DTBG. After Avco had made some of these loans, DTBG contacted Avco's manager McCormick about further loan business. McCormick attended three meetings

(two for DTBG and one for Koscot, an extremely similar venture run by identical organizers) in May through June, 1971. At these meetings, McCormick provided potential DTBG investors with blank Avco loan application forms. He also made a speech concerning obtaining financing through Avco at one of the meetings. Several members of the plaintiff class testified, and the trial court found, that McCormick represented to some plaintiffs that DTBG was a good quality investment. In July, 1971, McCormick's superior, Pok, ordered him to cease making any loans for investment in DTBG. (McCormick also attended a DTBG "go tour" after Pok put a stop to the loans.) Forty-eight people, eventually certified as a class, borrowed $2,000 or more from Avco to buy DTBG shares over an approximately six month period ending in July 1971.

In the ensuing litigation, the trial court certified the case as a Rule 23 (b) (3) class action. After trial, he ruled that both the promissory notes given by the plaintiffs for the loans and the shares of DTBG were "securities" within the meaning of the relevant federal securities statutes. He also found that Avco had solicited the plaintiffs' promissory notes and that the defendants' participation and enthusiasm in the sale of DTBG constituted a "misleading" of the plaintiffs in violation of §§ 2 (3) and 12 (2) of the Securities Act of 1933. (15 U.S.C. §§77b (3) and 77*l* (2), respectively). He entered judgment in favor of the plaintiffs for roughly $167,000, apportioning the judgment among the plaintiff class on the basis of money owed to Avco.

Following a bench trial, findings of fact and conclusions of law were filed in which the trial court did not find the requisite scienter by McCormick for Rule 10b-5 liability. He did conclude, however, that DTBG Adventures III and IV were securities within the meaning of the Act and that the efforts of Avco's manager in promoting their sale were

sufficient to render Avco liable under § 12 (2) of the Securities Act of 1933. He further found that Avco had not met its burden of showing that the representations made by its manager were made with due care. Avco is liable under the doctrine of *respondeat superior* for its manager's actions in this regard. *Holloway* v. *Howerdd,* 536 F.2d 690, 694-5 (6th Cir.1976) .

This court has reviewed the entire transcript of the trial and concludes not only that the factual findings of the trial judge with regard to the actions and intentions of Avco's manager are not clearly erroneous but that it is in total agreement with them. There was abundant evidence that Avco's manager allowed himself to be duped by the DTBG promoters into facilitating their dubious pyramidal scheme up to the point of actually representing to some of the borrowers that DTBG was a sound investment.

The manager, from all that appears in the evidence, was not guilty of any fraudulent intent but rather was taken in by the DTBG hoopla. He apparently swallowed everything from the "money humming" to the thousand dollar bills in the lapel buttonholes. In fact, far from attempting clandestinely to promote a known fraudulent venture, the manager actually suggested to his superiors that Avco adopt some of the DTBG promotional methods in its own public relations. This caused the manager's superiors to make an immediate investigation. In short order, they perceived that the the whole DTBG promotion was a chimera, forbade the manager to have anything further to do with it, and prohibited the making of any more loans to DTBG investors.

The fact that his supervisors so promptly perceived the inherent fallacy of the DTBG scheme indicates that its de-

fects were obvious and that the manager, although he may have been innocent of fraudulent intent, was certainly guilty of negligence. Nor was his sincerity of any comfort to the bilked investors. One who is sold the Brooklyn Bridge by means of sincere but negligent representations is nonetheless the possessor of a worthless asset.

Since the factual findings of the trial judge were clearly supported by the evidence, he was correct in finding liability against Avco, if his conclusion that Avco was liable under § 12 (2) was correct. We hold that it was and affirm his conclusion with regard to liability. The case must be remanded, however, for further proceedings on some of the issues, as hereinafter indicated.

ANALYSIS

Class Action Issues

Defendant contends that the trial court erred in certifying this case as a class action. This contention is without merit. It must be noted that the class was certified only as a F.R.Civ.P. 23 (b) (3) class action. For reasons stated in the trial judge's opinion filed when the class was certified, we feel that he was well within his discretion in certifying the class. *See Davis* v. *Avco Corp.*, 371 F.Supp. 782 (N.D. Ohio 1974). Despite the fact that as the case developed individual questions became more prominent *vis a vis* common questions of law and fact, there still were and are significant common questions such that we would not be justified in decertifying the class at this late date. *See Landy* v. *Amsterdam*, 96 F.R.D. 19, 22 (E.D.Pa. 1982); *In re Home-Stake Production Co. Securities*, 76 F.R.D. 351, 372-73 (N.D. Okla.1977); *Fox* v. *Prudent Resources Trust*, 69 F.R.D. 74, 82 (E.D.Pa.1975).

What are the Securities Involved in This Case?

Plaintiffs launched a multi-front attack in this action, contending both that the notes executed by the plaintiffs to Avco were securities and that the DTBG Adventures were also securities. They asserted liability under Rule 10b-5 and Section 12 of the 1933 Act based on the issuance of both types of "securities." The trial court found liability under § 12 (2) on the basis of defendants' involvement with both types of securities. It computed damages apparently on the basis of the moneys lost by plaintiffs in repayment of the loans to Avco.

We agree that the DTBG adventures were securities for the reasons discussed below, and that Avco is liable under § 12 (2) for having touted them to those plaintiffs who were caused to purchase them by the manager's representations. However, we cannot agree that the notes evidencing the loans from Avco were securities.

Although promissory notes can sometimes be considered securities, we think it obvious that the notes executed by the plaintiffs to Avco were not. They were notes executed to a finance company in the ordinary course of its business. The fact that Avco knew the loan proceeds would be used for an investment in DTBG does not in our opinion make the notes securities. *Chemical Bank* v. *Arthur Andersen & Co.*, 726 F.2d 930, 938-39 (2d Cir.1984); *Exchange National Bank of Chicago* v. *Touche Ross & Co.*, 544 F.2d 1126, 1137-38 (2d Cir.1976).

We do agree, however, that the DTBG adventures were securities. In this regard we concur with and adopt the analysis in *S.E.C.* v. *Glenn W. Turner Enterprises, Inc.*, 474 F.2d 476 (9th Cir.) *cert. denied*, 414 U.S. 821, 94 S.Ct. 117, 38 L.Ed.2d 53 (1973) and *S.E.C.* v. *Koscot Interplanetary, Inc.*, 497 F.2d 473 (5th Cir. 1974). We will not re-

iterate this analysis in the hope of keeping this opinion to a reasonable length. For reasons hereafter stated, we further hold that Avco is liable to at least some of the investors under § 12 (2) on the basis of its manager's efforts to promote DTBG adventures.

Liability Under § 12(2) of the 1933 Act

Determining secondary liability has long been a thorny problem in implementing securities laws.[1] Particularly is this true with regard to § 12 (2). Section 10 (b) of the Securities Exchange Act of 1934 and Rule 10b-5 provide a private action remedy roughly equivalent to that existing for fraud at common law. This remedy is not limited to "sellers," but applies also to persons collaterally involved in the transaction who made misrepresentations to promote the sale of securities with the requisite scienter. *Ernst* & *Ernst* v. *Hochfelder,* 425 U.S. 185, 96 S.Ct. 1375, 47 L.Ed.2d 668 (1976). In this circuit recklessness may constitute the required scienter. *Mansbach* v. *Prescott, Ball* & *Turben,* 598 F.2d 1017, 1023 (6th Cir. 1979); *Ingram*

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[1] *See, generally,* Kaminsky, *An Analysis of Securities Litigation Under Section 12(2) and How It Compares with Rule 10b-5,* 13 Hous.L.Rev. 231 (1976); Rapp, *Expanded Liability Under Section 12 of the Securities Act: When Is a Seller Not a Seller?* 27 Case W.Res.L.Rev. 445 (1977); Ruder, *Multiple Defendants in Securities Law Fraud Cases: Aiding and Abetting, Conspiracy, In Pari Delicto, Indemnification, and Contribution,* 120 U.Pa.L.Rev. 597 (1972) [hereinafter cited as *Ruder I*]; Ruder, *Securities Law Secondary-Liability Theories,* in *Fourteenth Annual Institute on Securities Regulation* 331 (1983) [hereinafter cited as *Ruder II*]; Comment, *Secondary Liability under Section 12(2) of the Securities Act of 1933,* 78 Nw.L.Rev. 832 (1983) [hereinafter cited as *Northwestern Comment*]; Comment, *Seller Liability Under Section 12(2) of the Securities Act of 1933: A Proximate Cause-Substantial Factor Approach Limited by a Duty of Inquiry,* 36 Vand.L.Rev. 361 (1983) [hereinafter cited as Vanderbilt Comment].

Industries v. *Nowicki,* 502 F.Supp. 1060, 1066 (E.D.Ky. 1980). However, the trial judge found neither deliberate fraud nor recklessness on the part of Avco or its manager. Therefore, plaintiff's 10b-5 allegations were not supported by the evidence at trial. The trial court's findings of liability must stand or fall on § 12 (2) of the 1933 Act.

Because of the variety of interpretations that have been given to § 12 (2) of the 1933 Act by the various federal courts, it is incumbent upon us to examine its place in the statutory scheme Congress has provided for the protection of investors in securities. Although there is a difference of opinion whether we should limit our inquiry to the statutory language, we must at least begin there. *See Touche Ross & Co.* v. *Redington,* 442 U.S. 560, 568, 99 S.Ct. 2479 2485, 61 L.Ed.2d 82 (1979); *Admiralty Fund* v. *Jones,* 677 F.2d 1289, 1294 n. 3 (9th Cir.1982); *Northwestern Comment, supra* note 1, *passim.* Section 12 of the Securities Act of 1933 (15 U.S.C. § 77*l* (1976)) provides as follows:

> **"Civil liabilities arising in connection with prospectuses and communications.**
>
> "Any person who—
>
> > "(1) *offers or sells a security* in violation of section 5, or
> >
> > "(2) *offers or sells a security* (whether or not exempted by the provisions of section 3, other than paragraph (2) of subsection (a) thereof), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus *or oral communication*, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under

> which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not *know, and in the exercise of reasonable care* could not have known, of such untruth or omission,
>
> shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security." (Emphasis added).

Section 2(3) of the 1933 Act (15 U.S.C. § 77b (1976)), in part, provides as follows:

> "The term 'sale' or 'sell' shall include every contract of sale or disposition of a security or interest in a security, for value. The term 'offer to sell,' 'offer for sale,' or 'offer' shall include every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value.

No definition of the term "seller" is to be found in the Act. It may be immediately discerned that the language of § 12(2)[2] on its face imposes a liability analogous to the equitable remedy of rescission only upon *sellers* of securities. If we are limited to a literal reading of the statute, it is obvious that the plaintiffs here must fail, because Avco was not in the literal sense the "seller" of DTBG securities.

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[2] It has been suggested that because of the strict liability imposed in § 12(1), the definition of seller should be more narrowly applied than in § 12(2), where due care is a defense. Since we find liability here under § 12(2), we limit our analysis to it and express no opinion as to the proper interpretation of § 12(1). *See Pharo* v. *Smith*, 621 F.2d 656, 665 n. 6 (5th Cir.1980).

Some courts have indeed held that § 12 (2) may be applied only to the literal seller of a security or one in privity with him. *Collins* v. *Signetics Corp.*, 605 F.2d 110 (3d Cir. 1979); *McFarland* v. *Memorex*, 493 F.Supp. 631 (N.D. Cal.1980). These courts put great emphasis on the consideration that the securities statutes are indeed *statutes*, and not mere commissions to the federal courts to ride abroad on a great white horse like the Lone Ranger righting all wrongs. They find support in recent admonitions of the Supreme Court of the United States of like tenor. *See, e.g.*, *Touche Ross & Co.* v. *Redington*, 442 U.S. 560, 578, 99 S.Ct. 2479, 2490, 61 L.Ed.2d 82 (1979); *Ernst & Ernst* v. v. *Hochfelder*, 425 U.S. 185, 200-01, 96 S.Ct. 1375, 1384-85, 47 L.Ed.2d 668 (1976). Also, the language of § 12 (2) providing for recovery based on the purchase price of the security would seem to support this interpretation.

On the other hand the Supreme Court has likewise indicated that the remedial purpose of the securities laws is not to be ignored in their interpretation. *Herman & MacLean* v. *Huddleston*, 459 U.S. 375, 103 S.Ct. 683, 689-90, 74 L.Ed.2d 548 (1983). As one commentator has aptly phrased it, the Supreme Court has called for a "flexible yet literal interpretation of the Securities Acts." *Vanderbilt Comment, supra* note 1, at 386. *But cf. Northwestern Comment, supra* note 1, *passim*.

Unfortunately, the Supreme Court has not yet synthesized these sometimes antithetical considerations with regard to § 12 (2). At one time some courts gave the term "seller" in § 12 (2) an extremely broad reading and held that anyone who participates to any degree in the sale of a security by means of negligent misrepresentations may be considered a "seller" thereunder. This view has come into disrepute, however, and has apparently been abandoned.

See discussion in *S.E.C.* v. *Murphy,* 626 F.2d 633, 650 n. 18 (9th Cir.1980) ; *Vanderbilt Comment, supra* note 1 at 367 ff.

Still other courts have followed an aiding and abetting analysis with regard to Section 12 (2) liability. *See, e.g., deBruin* v. *Andromeda Broadcasting Systems,* 465 F.Supp. 1276, 1279-80 (D.Nev.1979) ; *In re Caesars Palace Sec. Lit.,* 360 F.Supp. 366 (S.D.N.Y.1973) . This has been characterized as an "extremely liberal" approach. *Vanderbilt Comment, supra* note 1 at 364. It may or may not be, inasmuch as at least in this circuit aiding and abetting requires a general awareness that a fraudulent scheme is afoot and knowing and substantial assistance toward the success of that scheme. *S.E.C.* v. *Coffey,* 493 F.2d 1304 (6th Cir. 1974) , *cert. denied,* 420 U.S. 908, 95 S.Ct. 826, 42 L.Ed.2d 837 (1975) . *Accord: S.E.C.* v. *Washington County Utility District,* 676 F.2d 218, 226 (6th Cir. 1982) . It is doubtful whether these elements are present under the facts of this case. In any event the trial court, who followed the approach to § 12 (2) liability next discussed, did not use an aiding and abetting analysis. Also, an aiding and abetting theory seems inconsistent with the language of § 12 (2) . *See Ruder II, supra* note 1 at 345-46.

Inasmuch as we uphold liability under the "proximate cause" theory employed by the trial court, we need not address the issue whether or not an aiding and abetting approach may ever be employed under § 12 (2) .[3] We

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[3] Judge Lambros in a decision that primarily involved a pleading question has suggested that using the aiding and abetting approach under § 12 might be appropriate. *Sandusky Land Ltd.* v. *Uniplan Groups,* Inc., 400 F.Supp. 440, 444 (N.D.Ohio 1975). *But see Wright* v. *Schock,* 571 F.Supp. 642, 658 (N.D.Cal.1983); *Hokama* v. *E.F. Hutton Co.,* 566 F.Supp. 636, 642 (C.D.Cal.1983).

think it appropriate to note, however, that to distinguish between an aiding and abetting theory and the other theories advanced is not a mere semantic exercise, as has been suggested by at least one court. *In re Caesars Palace Sec. Lit.*, 360 F.Supp. 366, 380 (S.D.N.Y.1973). A case may be envisioned where there would be § 12 (2) liability under a *Coffey*-type aiding and abetting approach, but not under the analysis we here adopt. We will decide that case if and when it is before us. This case presents the converse situation.

The better reasoned cases adopt a view of § 12 (2) liability that transcends the strict approach (which limits liability to the literal seller or one in privity with him), which is narrower than the formerly employed broad participation approach and different — whether more conservative or more liberal is debatable — than the aiding and abetting approach.

We adopt the theory of § 12 (2) liability usually referred to as the "proximate cause" theory. *See Vanderbilt Comment, supra* note 1, at 370 ff; *Ruder II, supra* note 1, at 343-45. It has a history that is particularly interesting in the context of this litigation, since it originated in the Northern District of Ohio, which is also the place of origin of this case, although the theory has never been adopted or rejected by this court.

The proximate cause theory originated in *Lennerth* v. *Mendenhall*, 234 F.Supp. 59 (N.D.Ohio 1964). There, in language which has since been frequently quoted by courts and commentators alike, the court said:

> "[L]iability must lie somewhere between the narrow view, which holds only the parties to the sale, and the too-liberal view which would hold all who remotely participated in the events leading up to the transac-

> tion. We think that the line of demarcation must be drawn in terms of cause and effect: To borrow a phrase from the law of negligence, did the injury to the plaintiff flow directly and proximately from the actions of this particular defendant? If the answer is in the affirmative, we would hold him liable. But for the presence of the defendant Roger in the negotiations preceding the sale, could the sale have been consummated? If the answer is in the negative, and we find that the transaction could never have materialized without the efforts of that defendant, we must find him guilty.
>
> * * *
>
> "The hunter who seduces the prey and leads it to the trap he has set is no less guilty than the hunter whose hand springs the snare. We find that the activity of the corporate defendant's agent Roger is tantamount to that of a 'seller' within the liberal remedial spirit of the securities laws."

Lennerth, supra at 65.

Other courts, particularly the Fifth Circuit, have not only saluted the flag hoisted by the *Lennerth* court, but have honored it with ruffles and flourishes on many occasions. *See, Hill York Corp.* v. *American International Franchises, Inc.,* 448 F.2d 680, 692-93 (5th Cir.1971); *Junker* v. *Crory,* 650 F.2d 1349, 1360 (5th Cir.1981); *Croy* v. *Campbell,* 624 F.2d 709, 713 (5th Cir.1980); *Stokes* v. *Lokken,* 644 F.2d 779, 785 (8th Cir.1981); *S.E.C.* v. *Murphy,* 626 F.2d 633, 650 (9th Cir. 1980); *Vanderbilt Comment, supra* note 1, at 370 ff; *Ruder II, supra* note 1 at 343-45; *Northwestern Comment, supra* note 1 at 841-45.

For example, the Court of Appeals for the Fifth Circuit, said in *Hill York Corporation* v. *American International Franchises, Inc.,* 448 F.2d 680, at 692-93:

"The law is settled that a purchaser may only recover from his immediate seller. . . . The law is not settled, however, as to who may be a seller. *It is clear that a seller is not required to be the person who passes title.* For example, a broker for the seller has been subjected to liability under Section 12 (1) as a seller. *See III Loss, Securities Regulation 1713* (2d ed. 1961). This Circuit has implicitly rejected the strict privity concept on at least two prior occasions. (citations omitted). Although the term 'seller' has sometimes been accorded a broader construction under Section 12 (2) than under Section 12 (1), we adopt a test which we believe states a rational and workable standard for imposition of liability under either section. Its base lies between the antiquated 'strict privity' concept and the overbroad 'participation' concept which would hold all those liable who participated in the events leading up to the transaction. (citations omitted). We hold that the proper test is the one previously forged by the court in *Lennerth* v. *Mendenhall, supra.* '* * * the line of demarcation must be drawn in terms of cause and effect: To borrow a phrase from the law of negligence, did the injury to the plaintiff flow *directly and proximately* from the actions of this particular defendant? (citations omitted)." (emphasis added).

Later cases have broadened application of the proximate cause touchstone to include one whose efforts were a "substantial factor" in the sale of the securities. This has occurred to harmonize the securities law model with a similar development in general tort law. *See Pharo* v. *Smith,* 621 F.2d 656, 667 (5th Cir.1980); *Junker* v. *Crory,* 650 F.2d 1349, 1360 (5th Cir.1981). *See* Prosser, *Handbook of the Law of Torts,* §§ 41, 42 at 240, 248 (4th ed. 1971). Concerning the meaning of the term "substantial factor," *Restatement (Second) of Torts* §§ 432, 433 state:

"§ 432. **Negligent Conduct as Necessary Antecedent of Harm.**

" (1) Except as stated in Subsection (2), the actor's negligent conduct is not a substantial factor in bringing about harm to another if the harm would have been sustained even if the actor had not been negligent.

" (2) If two forces are actively operating, one because of the actor's negligence, the other not because of any misconduct on his part, and each of itself is sufficient to bring about harm to another, the actor's negligence may be found to be a substantial factor in bringing it about.

* * *

'§ 433. **Considerations Important in Determining Whether Negligent Conduct is Substantial Factor in Producing Harm.**

"The following considerations are in themselves or in combination with one another important in determining whether the actor's conduct is a substantial factor in bringing about harm to another:

" (a) the number of other factors which contribute in producing the harm and the extent of the effect which they have in producing it;

" (b) whether the actor's conduct has created a force or series of forces which are in continuous and active operation up to the time of the harm, or has created a situation harmless unless acted upon by other forces for which the actor is not responsible;

(c) the lapse of time."

The Ninth Circuit has described the proximate cause — substantial factor analysis as follows:

"In assessing proximate cause, courts focus first on whether a defendant's acts were the *actual cause* of the injury, *i.e.*, whether 'but for' the defendant's conduct, there would have been no sale. *Nicewarner* v. *Bleavins, supra,* 244 F.Supp. [261] at 266 (D.Colo.1965); *see Hill York Corp.* v. *American International Franchises, Inc., supra,* 448 F.2d at 693; *Lennerth* v. *Mendenhall, supra,* 234 F.Supp. at 65. A finding of 'but for' causation, alone, does not satisfy proximate cause, however. *See Nicewarner* v. *Bleavins, supra,* 244 F. Supp. at 266; R. Jennings & H. Marsh, *Securities Regulation* 1096 (4th ed. 1977); W. Prosser, *Handbook of the Law of Torts* 238-39, 244 (4th ed. 1971). Prior to the issuance of a security, numerous persons perform mechanical acts without which there could be no sale. For example, a printer may prepare key documents or a bank may advance cash to a customer upon the customer's presentation of any instrument and then pass the instrument to another person. Both would satisfy a 'but for' causation test, but these acts nonetheless do not render the defendants sellers. *See First Trust & Savings Bank* v. *Fidelity-Philadelphia Trust Co.,* 214 F.2d 320 (3d Cir.1954); Ruder, *Multiple Defendants in Securities Law Fraud Cases,* 120 U.Pa.L.Rev. 597, 646 (1972). Before a person's acts can be considered the proximate cause of a sale, his acts must also be a substantial factor in bringing about the transaction. *Lewis* v. *Walston & Co., Inc.,* 487 F.2d 617, 621-22 (5th Cir.1973). *See Restatement (Second) of Torts* § 431 (1965). Thus, a defendant will be held liable as a participant under § 12 if his acts *were both necessary to and a substantial factor in the sales transaction. See Lewis* v. *Walston & Co., Inc., supra,* 487 F.2d at 621-22."

S.E.C. v. *Murphy,* 626 F.2d at 650. (Emphasis added).

The policy question with which the courts and commentators are struggling may be stated as follows: In light of the fact that the consequence of denominating anyone a

"seller" under § 12 (2) is to force that person to bear the burden of persuasion in establishing his lack of negligence for representations made by him, what sort of involvement in the sale of a security should be required to justify such inclusion?

We hold that considering participants in the selling effort whost acts meet the substantial factor test as described in *Murphy, supra,* as "sellers" under § 12 (2) constitutes an appropriate synthesis of the sometimes antithetical policies that the securities laws are to be construed as statutes while, at the same time, giving effect to their far-reaching remedial purpose.

This model does no violence to the statutory scheme and is not contrary to the requirement of scienter for Rule 10b-5 liability. Under Rule 10b-5 scienter is required for imposition of general damages analogous to those recoverable for fraud. Under the proximate cause approach to § 12 (2), negligence is required for imposition of the more limited remedy of rescission on one who caused the sale. The approach, therefore, seems to complete the statutory scheme rather than violate it.

Some commentators fear that such an approach is too broad, imposing liability on more persons than Congress intended. *See Northwestern Comment, supra* note 1, *passim*. However, denominating a defendant a "seller" under § 12 (2) does not result in automatic liability. Such a defendant may escape by showing an exercise of ordinary care.

We believe that the following considerations are pertinent to an analysis of whether a § 12 (2) seller has established this affirmative defense: (1) the quantum of decisional (planning) and facilitative (promotional) participation, such as designing the deal and contacting and

attempting to persuade potential purchasers, (2) access to source data against which the truth or falsity of representations can be tested, (3) relative skill in ferreting out the truth (for example, in this case Avco's manager had comparatively greater skill in evaluating judgments based on subsidiary facts, since he performed a similar function in the process of investigating the creditworthiness of borrowers), (4) pecuniary interest in the completion of the transaction, and (5) the existence of a relationship of trust and confidence between the plaintiff and the alleged "seller." These are the circumstances that determine whether a person has exercised due care in this context. *See* R. Coffey, *Securities Regulation: An Analysis of Policy and Law* 100ddd-100iii (unpublished multilith manuscript) (1981).

CONCLUSION

Although we agree with the trial court's findings of liability under § 12(2) of the 1933 Act with regard to those class members who did testify that the representations of Avco's manager were the cause of their investing in DTBG, it is necessary that findings of the existence or non-existence of such causal relationship be made with regard to each class member, inasmuch as the circumstances surrounding their individual decisions to invest differ.

We wish to make it clear that we are not introducing reliance on the part of the purchasers as a requirement of § 12(2). It is clear that scienter and reliance are not prerequisites for recovery under this section. *Wigand* v. *Flo-Tek, Inc.*, 609 F.2d 1028, 1034 (2d Cir.1980). The question is the substantiality of the intrusion of Avco's manager into the selling process (that is, his presence at meetings, his making speeches, his furnishing forms, and in

general his contribution to the selling momentum). However, in this case the impact of these activities varied from plaintiff to plaintiff.[4] With regard to the plaintiffs that testified, the evidence was more than sufficient to justify the finding that the manager's activities were a substantial factor in their decision to purchase DTBG securities. Avco rightly argues, however, that it has not been established that all of the members of the plaintiff class were affected by the manager's activities.

Similarly, the case must be remanded for further findings on damages. The trial court based its damages findings on the theory that the Avco notes were securities, and awarded each class member damages on the basis of the amount he or she lost by reason of the loans. Rather, the damages should have been computed, as required by § 12 (2), on the basis of the amount invested in the DTBG adventures we have held to be securities. This did not correspond in every instance with the amount of the loan from Avco. Further, some of the investors did recoup some of their investment by selling the adventures, and this, too, must be considered.

Also Avco's manager McCormick is personally liable under the analysis we have herein adopted, and the judgment in his favor must be reversed.

Therefore, this case is AFFIRMED with regard to the findings of liability of certain class members under § 12 (2) and reversed and remanded for further proceedings indicated herein.

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[4] In many cases the contribution of the defendant to the selling effort may be so great that it may be considered a substantial factor in the sales made to all plaintiffs.

LIVELY, Chief Judge, concurring and dissenting.

I concur in the majority's conclusion that the district court properly certified this case as a class action. I also concur in the majority's affirmance of the district court's holding that the sales of "adventures" in Dare to Be Great (DTBG) were sales of "securities" within the meaning of federal securities laws. In addition, I concur in the majority's conclusion that the district court erred in holding that the notes from plaintiffs to Avco were "securities" within the meaning of the federal securities laws. Finally, I concur in the majority's affirmance of the district court's finding that there was no liability to the plaintiffs under section 10 (b) of the 1934 Act and Rule 10b-5 for lack of proof of scienter.

I respectfully dissent, however, from the majority's affirmance of the judgment for the plaintiffs based on the theory that Avco and McCormick were liable as "sellers" of the DTBG adventures under section 12 (2) of the 1933 Act. In the first place, though the majority purports to affirm a finding by the district court of liability under section 12 (2) I am unable to conclude that this was the basis of the district court's judgment. The district court considered the notes securities, and the whole tenor of its findings and conclusions derives from the erroneous holding that the notes were securities. This is shown most clearly by the measure of damages which the district court applied. The district court granted recovery to the plaintiffs of the amounts paid to Avco on the promissory notes. The recovery is unrelated to the total amounts of their investments in DTBG adventures, yet these were the only securities involved in the transaction. The remedy prescribed for violation of section 12 (2) is recovery of "the consideration paid for such security. . . ." 15 U.S.C. §77*l*

(2) (1970). If the district court intended to find the defendants liable under section 12 (2) for sales of the DTBG "adventures," the recovery would necessarily have been related to the amount of the plaintiffs' investments in DTBG, not to the amounts they borrowed from Avco to make these investments. I would reverse the judgment of the district court as being based on the erroneous conclusion that the promissory notes were securities.

In my opinion the majority has misread section 12 (2) and has reached the wrong result, even if it is assumed that the district court did base its finding of liability on section 12 (2). The federal securities laws are complex, but they do display a studied approach to a variety of problems. Different participants in various stages and types of securities transactions are treated individually. In this scheme section 12 (2) of the 1933 Act focuses on the liability of persons who offer or sell securities using communications which contain untrue statements or which omit material facts. Only sellers and offerors of securities are reached by section 12 (2). Other participants in securities transactions are treated in other provisions of the securities laws. To bring other participants within the reach of section 12 (2) by invoking the broad "remedial purposes" of federal securities legislation is contrary to a consistent refusal by the Supreme Court to so construe these statutes. For example in *Touche Ross & Co.* v. *Redington,* 442 U.S. 560, 578, 99 S.Ct. 2479, 2490, 61 L.Ed.2d 82 (1979), the Court stated:

> The invocation of the "remedial purposes" of the 1934 Act is similarly unavailing. Only last Term, we emphasized that generalized references to the "remedial purposes" of the 1934 Act will not justify reading a provision "more broadly that its language and the statutory scheme reasonably permit." *SEC* v. *Sloan,* 436 U.S. 103, 116 [98 S.Ct. 1702, 1711, 56 L.Ed2d

> 148] (1978) ; see *Ernst* & *Ernst* v. *Hochfelder,* 425 U.S., at 200 [96 S.Ct. at 1384]. Certainly, the mere fact that § 17 (a) was designed to provide protection for brokers' customers does not require the implication of a private damages action in their behalf. *Cannon* v. *University of Chicago, supra* [442 U.S.] at 688, and n. 9 [99 S.Ct. at 1953, and n. 9]; *Securities Investor Protection Corp.* v. *Barbour, supra* [421 U.S.], at 421 [95 S.Ct. at 1739]. To the extent our analysis in today's decision differs from that of the Court in *Borak,* it suffices to say that in a series of cases since *Borak* we have adhered to a stricter standard for the implication of private causes of action, and we follow that stricter standard today. *Cannon* v. *University of Chicago, supra* [442 U.S.], at 688-709 [99 S.Ct. at 1953-1964]. The ultimate question is one of congressional intent, not one of whether this Court thinks that it can improve upon the statutory scheme that Congress enacted into law.

In relying on the "proximate cause" theory to treat Avco and McCormick as sellers for purposes of section 12 (2) the majority contravenes an express limitation placed by the Supreme Court on application of the federal securities laws. In *Touche Ross* the Court described reliance on tort principles as a basis for finding a private right of action under the 1934 Act as "entirely misplaced." The Court emphasized that the problems is one of statutory construction, not the application of general principles of substantive law. 442 U.S. at 568, 99 S.Ct. at 2485.

I agree with the construction of section 12 (2) and the reasoning applied by Judge Aldisert in *Collins* v. *Signetics Corp.,* 605 F.2d 110, 113 (3d Cir. 1979) :

> We have no difficulty in concluding that Congress intended the unambiguous language of § 12 (2) to mean exactly what it says: "Any person who — . . . (2)

offers or sells a security . . . shall be liable to the person purchasing from him . . . ." This section is designed as a vehicle for a purchaser to claim against his immediate seller. Any broader interpretation would not only torture the plain meaning of the statutory language but would also frustrate the statutory schema because Congress has also provided a specific remedy for a purchaser to utilize against the issuer as distinguished from the seller of a security. Thus, § 11 gives anyone acquiring a security a specific right of action for misrepresentations against every person who signed the registration statement, or was a director or partner of the issuer or prepared a certified statement contained in the registration statement, or was an underwriter with respect to the security. 15 U.S.C. § 77k.

Ascertainment of congressional intent with respect to the standard of liability created by a particular section of the securities acts must "rest primarily on the language of that section." *Ernst and Ernst* v. *Hochfelder,* 425 U.S. 185, 200, 96 S.Ct. 1375, 1384, 47 L.Ed.2d 668 (1976). In interpreting liability provisions of the acts, we must respect recent Supreme Court teachings that militate against excessively expansive readings, Thus, proof of an actual purchase or sale rather than a lost opportunity to purchase is necessary to recover for a violation of Rule 10b-5, *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723, 95 S.Ct. 1917, 44 L.Ed.2d 539 (1975), and scienter is necessary to establish a 10b-5 violation, *Ernst* & *Ernst* v. *Hochfelder, supra.* A defeated tender offeror has no implied cause of action for damages under § 14(e) of the Securities Exchange Act of 1934 or under Rule 10b-5. *Piper* v. *Chris-Craft Industries, Inc.,* 430 U.S. 1, 42, 97 S.Ct. 926 [949,] 51 L.Ed.2d 124 (1977). Without allegations of manipulation or deception, no 10b-5 cause of action exists for simple breach of fiduciary duty to minority stockholders. *Santa Fe Industries, Inc.* v. *Green,* 430 U.S. 462, 97 S.Ct. 1292, 51 L.Ed.2d 480 (1977). Section 12(k) of

the Exchange Act does not authorize the Commission to suspend trading in a security for more than one ten-day period on the basis of a single set of circumstances, *SEC* v. *Sloan,* 436 U.S. 103, 98 S.Ct. 1702, 56 L.Ed.2d 148 (1978), and an employees' non-contributory, compulsory pension plan is not a security within the meaning of the Securities Acts, *International Brotherhood of Teamsters* v. *Daniel,* 439 U.S. 551, 99 S.Ct. 780, 58 L.Ed.2d 808 (1979).

One other comment appears in order. Avco and McCormick obviously were not sellers or offerors of DTBG adventures. Yet the majority holds them liable as indirect participants whose activities were a substantial factor in the transactions between the plaintiffs and DTBG. In *Ernst* & *Ernst* v. *Hochfelder,* 425 U.S. 185, 96 S.Ct. 1375, 47 L.Ed.2d 668 (1976), the Supreme Court held that secondary liability may not be imposed under section 10(b) for mere negligence; scienter is required. The majority has found that there was no scienter, and thus no Rule 10b-5 liability. By permitting recovery under section 12(2) on the basis of McCormick's failure to show that he would not have known of the fraudulent nature of the DTBG scheme even if he had exercised reasonable care, the majority permits the plaintiffs to evade the *Ernst* & *Ernst* requirement that secondary liability may be based only on scienter.

I would reverse the judgment of the district court.

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF OHIO
WESTERN DIVISION

No. C-73-226

CLEVESTER DAVIS, et al.,

Plaintiffs,

-vs-

AVCO CORPORATION, et al.,

Defendants.

FINDINGS OF FACT
and
CONCLUSIONS OF LAW

(Filed March 30, 1981)

WALINSKI, J:

This cause came on for trial to the Court on August 13, 14, and 15, 1979, after years of discovery. Although filed as a potential national class action, discovery revealed that this was a local problem that would not have withstood a Rule 23, F. R. Civ. P. numerosity challenge.

In an exhaustive analysis of the complaint in response to the defendants' motion to dismiss, this Court assumed jur-

isdiction of this action under the Securities Act of 1933, 15 U.S.C. § 77 *et seq.*, and the Securities Exchange Act of 1934, 15 U.S.C. § 78 *et seq.*

The pendent state claims under the Ohio Blue Sky Laws, Ohio Rev. Code § 1707.01 *et seq.*, and a common law count for fraud and deceit were dismissed on December 9, 1977, pursuant to defendants' motion for summary judgment.

In *Davis* v. *Avco Corporation,* 371 F. Supp. 782 (N.D. Ohio W.D. 1974), the Court allowed four (4) counts for securities violations to stand, but on trial some of the rulings of the Court in *Davis, supra,* were not supported by the evidence.

The Court in *Davis* also certified a conditional class comprised of:

> All persons who borrowed money through loans obtained from the defendants, including the parent corporation, affiliates, and subsidiaries throughout the State of Ohio, for the purpose of entry into and participation in a security commonly known as DARE TO BE GREAT, INC. (DTBG) Adventures 3 and 4 and the $1,000.00 plan within three (3) years of the filing of this action.

Following the 1974 Order in *Davis,* extensive discovery was undertaken, which finally resulted in the discovery that only the Toledo, Office of Avco Financial Services, Inc. and its manager, Lee McCormick, were involved in DTBG financing with only forty-eight (48) individuals involved. Four (4) of the forty-eight (48) individuals opted out of this class action. Nevertheless, the class as now delineated was and is the most efficient way of resolving this dispute judicially.

At the conclusion of plaintiffs' case, the other Avco subsidiaries and affiliates were dismissed as not being involved in DTBG financing, leaving only Lee McCormick and the

Toledo, Ohio office of Avco Financial Services, Inc. (AVCO) as defendants.

AVCO is a Delaware corporation licensed to do business in Ohio. DTBG is a pyramidal scheme whose modus operandi is well documented in two cases and since 1974 has collapsed. *See SEC Comm'n* v. *Glenn W. Turner Enterprises, Inc.*, 474 F.2d 476 (9th Cir. 1973), and *SEC Comm'n* v. *Koscot Interplanetary, Inc.*, 497 F.2d 473 (5th Cir. 1974). The instant case is a spinoff from *SEC* v. *Turner, supra* (DTBG).

At all times relevant hereto, Lee McCormick was the manager of the Toledo, Ohio office of AVCO, and the only one making loans for entry into DTBG.

At the trial of this cause, the facts adduced fell short of the allegations of the remaining four (4) counts of the complaint as analyzed in *Davis, supra.*

FINDINGS OF FACT

1) Plaintiff Clevester Davis and the intervenors Jimmie Lee King and Virginia Ann King, husband and wife, are citizens of the States of Ohio.

2) Defendant AVCO is a Delaware Corporation licensed to do business in Ohio.

3) The only office making loans for entry into DTBG was the AVCO office located at 905 Madison Avenue, Toledo, Ohio.

4) Defendant Lee McCormick was, at all times relevant, the manager of the Toledo AVCO office.

5) Forty-eight (48) loans were identified which were made for the purpose of *investing* in DTBG. Of the forty-eight (48) loans, four (4) borrowers opted out of the class leaving forty-four (44) seeking a remedy.

6) Although the class remaining may not withstand a Rule 23 F. R. Civ. P. challenge as to the numerosity requirement, a class action is the best way to adjudicate this litigation.

7) In *SEC* v. *Turner, supra,* the sales of DTBG "Adventures" were found to be sales of "shares" under the Securities Acts of 1933 and 1934, 15 U.S.C. §§ 77a *et seq.* and 78a *et seq.*

8) This Court adopts the conclusions and findings in *SEC* v. *Turner* that the sale of "Adventures" were sales of securities and were a fraudulent pyramidal scheme, and the Court will not repeat the analyses herein, even though they were partially relitigated in this cause of action.

9) The DTBG scheme was a pyramid operation accompanied by hard-sell tactics, a revivalistic aura at the Adventure meetings and "Go-Trips," trips to other cities' meetings, and a show of wealth. Adventures I and II were motivational tapes and materials and were only of a nominal worth. Adventures III and IV, selling for $2,000.00 and $5,000.00 respectively, which were purchased by the unwitting participants, was the right to sell the scheme to others, and this value was dubious because of saturation of the market and the pyramiding inherent herein.

10) The Toledo AVCO office made a few loans for investing in DTBG. Thereafter, Defendant McCormick was contacted by DTBG personnel for further referral possibilities.

11) Defendant McCormick thereafter attended approximately three (3) meetings with AVCO forms and made known the fact that AVCO could and would make loans for use in purchasing DTBG "Adventures." Defendant McCormick also attended a "Go-Trip."

12) Defendants AVCO and McCormick maintain that the notes of the borrowers are normal, simple commercial consumer loans made according to AVCO's three "C's" policy, Character, Capacity to repay, and Collateral.

13) These notes may be deemed securities within the meaning of the Security Act of 1933, and the Securities Exchange Act of 1934, if events leading up to the issuance of the notes by the borrowers were such as to call into being the anti-fraud protections of the securities laws.

14) The Court finds that the commercial setting and economic realities of these transactions made the notes in question "securities" within the meaning of the securities laws.

15) Defendants solicited the securities from the plaintiffs, and the supportive and enthusiastic aid given by the defendants was the equivalent of a misleading statement. The fact that Defendant McCormick received no remuneration from DTBG, other than the considerable loan business generated for the Toledo AVCO office, and that he never became a direct participant, gives credence to the fact that he was suspicious of the DTBG scheme.

CONCLUSIONS OF LAW

1) Federal securities are remedial in nature and should be broadly construed so as to effectuate their purposes. 15 U.S.C. §§ 77a *et seq.* and 78a *et seq.*

2) The economic realities of the transactions which are the subject of this action must be taken into account in identifying commercial consumer loan notes as "securities." 15 U.S.C. §§ 77a *et seq.* and 78a *et seq.*

3) The term "security" must be viewed as a transaction whose characteristics distinquish it from the generality of

transactions so as to create a need for the fraud procedures, protections, and remedies provided by the securities laws. 15 U.S.C. §§ 77a *et seq.* and 78a *et seq.*

4) Promissory "notes" are "securities" if the events leading to their issuance were such as to call into play the anti-fraud protections of the securities laws. 15 U.S.C. §§ 77b (1) and 78c (a) (10).

5) When the defendants solicited notes for the purpose of entry into the DTBG scheme, when DTBG was under considerable SEC investigation and prosecution, the defendants should have known that DTBG was probably a fraudulent scheme.

6) The participation of the defendants and enthusiasm displayed constituted a misleading of the plaintiffs pursuant to 15 U.S.C. §§ 77b (3) and 77L (2).

7) The use of a manipulative device by an unregistered dealer or broker constitutes a valid claim. 15 U.S.C. § 78o (c).

8) The plaintiffs need not show actual reliance on the statements and acts of the defendants. 15 U.S.C. § 78j (b).

Accordingly, the Court enters judgment for the plaintiff class and against the defendants. However, the Court orders the judgment paid out of funds paid to AVCO, less the amounts paid into escrow which are to be returned to the respective plaintiffs, and less any class member payments that were compromised or settled as the result of separate lawsuits.

The damages herein were computed as to the amounts paid to AVCO from the date of the final payments of the notes in question with interest at the rate of 8%, not compounded, from that date to March 31, 1981.

The monies accumulated in the escrow accounts are to be returned to plaintiffs involved, together with interest accumulated, if any.

The loan amounts, total repaid, and date repaid, were obtained from Exhibit 48 produced by AVCO.

Attached hereto and made a part of this judgment are six (6) charts (Appendix A) showing the status of the various categories of plaintiffs, together with an attached explanation of the charts.

Judgment in the sum of $167,072.57 is awarded the plaintiffs and against the Defendant AVCO. Defendant McCormick received none of the monies, nor did he have the use of them during the pendency of this lawsuit.

Out of the fund thus created, plaintiffs' counsel are awarded 25% as attorneys fees or $41,768.14. Of that sum 2% or $3,341.45 is to be paid to Matt Kehoe, attorney for the intervenors.

Plaintiffs are relieved of any and all obligations and liability which arise for loans or portions of loans made for the purpose of investing in DTBG.

IT IS SO ORDERED.

/s/ NICHOLAS WALINSKI
UNITED STATES
DISTRICT JUDGE

Toledo, Ohio.

March 27, 1981.

APPENDIX A

EXPLANATION OF ATTACHED CHARTS:

I. Class Members Paid in Full – Exhibit 48 clearly showed the amounts paid to AVCO by these plaintiffs and date final payment was made.

II. Escrow Account Individuals – The three named plaintiffs ceased making payments to Defendant AVCO when they consulted attorneys. The two named plaintiffs represented by ABLE (Clevester Davis and Donald Kimberly) made payments thereafter into escrow accounts. This chart depicts how much each paid to AVCO and the date the last payment was made to AVCO.

III. Irregular Loan Amounts – These individual class members borrowed more than the standard $2,000.00 for purposes of investing in DTBG. The amount paid to AVCO shows how much was borrowed and repaid for the purpose of investing in DTBG.

IV. Individuals Charged to P & L – Exhibit 48 describes these plaintiffs and their accounts as chargeable to "P & L", which is presumed to mean profit and loss, i.e., written off as bad debt. Damages to each of these individuals is based on amount repaid AVCO plus interest accumulated.

V. Accounts Refinanced and Current or Open – According to Exhibit 48, these class members refinanced their loans subsequent to the initial DTBG investment loan. The damage is premised on the individual class member having repaid the original DTBG investment loan with interest accumulating from date original DTBG loan was due.

VI. Individuals Where Status Shows: "AAA to [Another AVCO office]" – These individuals moved and their

loan repayments were transferred to another AVCO office. Damages are premised on loans having been paid in full by due date.

SPECIAL NOTE

WALTZ, Randa – Although she is a class member who did not "opt out" of the class, it is noted that she had an independent lawsuit which was settled on January 28, 1972. Thus, her loan is not included in the damages.

I. CLASS MEMBERS PAID IN FULL

NAME	AMOUNT REPAID	AMOUNT REPAID + INTEREST ACCUMULATED	DATE PAID IN FULL
BRENNAN, William	$2,672.78	$4,044.71	10/16/74
CULLEN, Mildred	2,672.78	4,151.62	04/08/74
DAMSCHRODER, William	2,672.78	4,650.63	12/30/71
DAVIS, Raymond (1)	2,672.78	3,795.34	12/19/75
DITTMAN, David	2,672.78	4,080.26	08/27/74
FUQUA, Avery	2,672.78	3,919.89	05/23/75
HEFFELFINGER, Karl	2,672.78	4,347.54	05/01/73
HOLLABAUGH, Richard	2,672.78	4,454.45	11/24/72
KASPRZAK, John	2,672.78	3,830.89	10/23/75
KING, Silas	2,672.78	4,418.90	01/17/73
KLEIN, David	2,672.78	4,098.17	07/09/74
LIGHTHALL, Merit	2,672.78	4,062.62	09/13/74
MICHAM, Jerry	2,672.78	4,222.99	12/18/73
MOORE, Willie	2,672.78	3,759.53	02/05/76
NOLTE, Elenor	2,672.78	4,116.08	06/25/74
PATTERSON, Norman	2,656.97	4,091.73	06/25/74
PELLAND, Raymond	2,656.97	4,127.07	04/17/74
SCHLADETSCH, Dale	2,672.78	4,579.27	04/06/72
STINSON, Gerald	2,672.78	4,240.63	11/21/73
SWINT, Richard (2)	2,672.78	4,116.08	06/17/74
TERRY, Clyde	2,672.78	4,525.81	07/20/72
VINSON, Thomas	2,672.78	4,080.26	08/16/74
WALKER, Eli	2,672.78	3,991.26	01/27/75
WARREN, Herman	2,656.97	4,038.59	09/30/74
WATKINS, Jack	2,672.78	4,169.53	03/18/74
TOTAL		$103,913.85	

(1) Although AVCO memorandum of 3/18/76 (Exhibit 48) shows that on 12/19/75 there was a balance of $141.98, Mr. Davis informed plaintiffs' counsel that the note was paid off in its entirety.

(2) Refinanced on 6/23/71 for $11,520. They divorced. She pays entire amount repaid. Interest based on date $2,672.78 would have been paid in full.

II. ESCROW ACCOUNT INDIVIDUALS/PAYMENTS THEY MADE TO AVCO

NAME	AMOUNT PAID TO AVCO	PAID TO AVCO + INTEREST ACCUMU-LATED	LAST DATE PAYMENT MADE TO AVCO
DAVIS, Clevester	$1,753.85	$2,782.65	11/28/73 (1)
KIMBERLY, Donald	2,026.29	3,201.53	12/ 5/73 (1)
KING, Jimmy L.	1,236.60	2,060.91	11/18/72 (2)
TOTAL		$8,045.09	

(1) Individual ceased making payments to AVCO and began paying into an escrow account held by plaintiffs' counsel.

(2) Made payments to AVCO through that date, as which time ceased making payments to AVCO at advice of private counsel (John Rust).

III. IRREGULAR LOAN AMOUNTS

NAME	AMOUNT PAID TO AVCO	AMOUNT PAID TO AVCO + INTEREST ACCUMULATED	DATE PAID IN FULL
WEIS Donald (1)	$5,160.00	$8,978.40	12/16/71
SCHAEFFER, Melvin (2)	4,000.00	6,293.20	1/ 2/74
GILLEN, Thomas (3)	4,315.05	6,702.56	4/ 9/74
TOTAL		$21,974.16	

(1) Donald Weis' loan application shows that entire amount was to be used for DTBG.

(2) Melvin Schaeffer borrowed $11,400. From loan applications, it appears that $4,000 went to DTBG. Entire loan paid in full on 1/2/74.

(3) Thomas Gillen borrowed $5,759.29 and repaid AVCO $8280.00. Application for loan shows that $3,000 went to DTBG. Balance on 2/27/76 which was most recent data provided by AVCO was $273.42. The amount repaid of $4313.05 is based on that portion of the loan attributable to DTBG. Used three years from date of loan as initial repayment of $3,000 DTBG loan.

IV. INDIVIDUALS CHARGED to "P & L"

NAME	AMOUNT PAID TO AVCO	AMOUNT PAID TO AVCO + INTEREST ACCUMU-LATED	DATE BALANCE BECAME INACTIVE
BUTLER, Craig	$1,057.47	$1,797.69	06/15/72
JOHNSON, William	676.90	1,128.12	11/20/72
PAUFF, Frederick	1,447.14	2,382.86	02/21/73
REMMERT, Richard	1,094.50	1,714.64	02/25/74
ROOD, Francis	576.23	968.06	09/18/72
SPAULDING, Keith	390.72	661.60	07/19/72
TOTAL		$8,652.97	

"P & L" is presumed to mean "profit loss", i.e., written off as bad debt. Interest based on amount repaid, acruing from date balance became inactive.

V. ACCOUNTS REFINANCED AND CURRENT OR OPEN ACCORDING TO MOST UP TO DATE RECORDS PROVIDED BY AVCO

NAME	AMOUNT BORROWED	AMOUNT BORROWED + INTEREST ACCUMULATED	DATE ORIGINAL DTGB LOAN DUE
BIDDLE, Robert	$2,672.78	$4,098.17	07/04/74
TRIBBLE, Robert	2,672.78	4,116.08	06/18/74
PERRY, Percy	2,672.78	4,187.17	02/11/74
TOTAL		$12,401.42	

VI. INDIVIDUALS WHERE STATUS SHOWS: "AAA TO [ANOTHER AVCO OFFICE]"

NAME	AMOUNT BORROWED	AMOUNT REPAID + INTEREST	LAST PAYMENT DATE
BRANCO, George	$2,672.78	$4,098.17	07/06/74
COOK, James	2,456.84	3,799.74	05/21/74
HOFFMAN, Stuart	2,672.78	4,187.17	02/12/74
TOTAL		$12,085.08	

APPENDIX C

Nos. 82-3553
82-3572

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

CLEVESTER DAVIS; JIMMIE LEE KING;
AND VIRGINIA ANN KING,

Plaintiffs-Appellees,
Cross-Appellants,

vs.

AVCO FINANCIAL SERVICES, INC.,

Defendant-Appellant,
Cross-Appellees,

LEE McCORMICK,

Defendant.

ORDER

[Filed September 7, 1984]

BEFORE: LIVELY, Chief Judge; JONES, Circuit Judge; and BERTELSMAN, District Judge*.

This mater is before the Court on motions for rehearing

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* Hon. William O. Bertelsman, United States District Judge for the Eastern District of Kentucky, sitting by designation.

and rehearing en banc filed by both parties. The court having not favored a rehearing en banc on either motion, both motions have been referred to the original panel for disposition. Having carefully reviewed the memoranda of the parties and the entire record herein, the court is of the view that all matters raised in the motions were thoroughly discussed in the previous opinion of the panel herein. Although the authorities are not uniform in the disposition of the principal issues herein, the majority and minority opinions reflect the views of the panel concerning the merits of the various approaches and the other issues in the case. No reason appears why these views should be changed. Therefore, the court being advised,

IT IS ORDERED that the motions of both parties for a rehearing en banc be, and they are, hereby denied.

ENTERED BY ORDER OF THE COURT
John P. Hehman, Clerk
/s/ J. P. HEHMAN

Office-Supreme Court, U.S.
FILED
JAN 4 1985
ALEXANDER L. STEVAS,
CLERK

No. 84-901

In the Supreme Court of the United States

October Term, 1984

AVCO FINANCIAL SERVICES, INC.,
Petitioner,

vs.

CLEVESTER DAVIS, *et al.*,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

RESPONDENTS' BRIEF IN OPPOSITION

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RESTATEMENT OF QUESTION PRESENTED FOR REVIEW

Whether a person who actively promotes and substantially assists in the sale of a security may be liable under §12(2) of the Securities Act of 1933.

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STATUTORY PROVISION INVOLVED

An additional statutory provision involved necessary to address the petition for writ is §2(3), 15 U.S.C. §77b(3), of the Securities Act of 1933. It provides in pertinent part:

> (3) The term "sale" or "sell" shall include every contract of sale or disposition of a security or interest in a security, for value. The term "offer to sell," "offer for sale," or "offer" shall include every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value.

SUMMARY OF ARGUMENT

1. Defendant Avco Financial Services, Inc. (AFS) and its branch manager, defendant Lee McCormick, actively participated in and promoted the Dare To Be Great (DTBG) securities. In the Toledo, Ohio area, they actively worked in concert with the DTBG representatives in selling securities. The Third Circuit's decision in *Collins v. Signetics Corp.*, 605 F.2d 110 (1979), expressly avoided the issue of whether under such facts §12(2) liability can be imposed. Thus, there is not a clear conflict between the Sixth Circuit's opinion in this case and the Third Circuit.

2. The plain language of §12(2) imposes liability on any person who "offers or sells" a security. Section 2(3), 15 U.S.C. §77b(3), defines "offer" to "include every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value." AFS's conduct in the promotion and sale of DTBG securities comes within this definition.

REASONS WHY THE PETITION FOR WRIT SHOULD BE DENIED

1. UNDER THE FACTS OF THIS CASE, THERE IS NOT A DIRECT AND IRRECONCILABLE CONFLICT BETWEEN THE SIXTH AND THIRD CIRCUITS.

At the trial of this class action, five of the plaintiff class members testified. Like each of the class members, they had executed promissory notes to AFS in return for loan proceeds used to purchase DTBG adventures. A unanimous court of appeals affirmed the district court's holding that the adventures sold were "securities" (App. 9a, 23a).[1] The court of appeals held that "[w]ith regard to the plaintiffs that testified, the evidence was more than sufficient to justify the finding that the [AFS] manager's activities were a substantial factor in their decisions to purchase DTBG securities" (App. 22a). The trial court had found that defendants gave "supportive and enthusiastic aid" to DTBG (App. 32a).[2] The appellate court "agree[d] with the trial court's findings of liability under §12(2) of the 1933 Act with regard to those class members who did testify that the representations of Avco's manager were the cause of their investing in DTBG . . ." (App. 21a).

The Sixth Circuit majority opinion concluded that AFS was liable as a "seller" under §12(2), 15 U.S.C. §77l(2),

---

1. All references in this brief to the appendix are to the petitioner's appendix in its petition for writ, No. 84-901.

2. The court of appeals was "in total agreement" with the factual findings of the district court regarding the actions and intentions of AFS's manager (App. 7a).

of the Securities Act of 1933, where its activities were a substantial factor in an individual's decision to invest in DTBG (App. 21a-22a).

In *Collins v. Signetics Corp.*, 605 F.2d 110 (3rd Cir. 1979), the buyers failed to allege that there was any "special relationship" between the underwriters who actually sold the securities and the defendants in that suit. In the absence of that relationship, the Third Circuit held that the appeal must fail. 605 F.2d at 113. Under those facts, the court held that the buyers had no claim against the defendants under §12(2), because they had not purchased the securities from them. 605 F.2d at 114.

The Third Circuit in *Collins* expressly recognized that in a decision from the previous year, *Monsen v. Consolidated Dressed Beef Co., Inc.*, 579 F.2d 793 (3rd Cir.), *cert. denied*, 439 U.S. 930 (1978), it left open the issue of whether there can be aider-abettor liability under §12(2). The *Collins* court did not seek to address that issue since appellants' evidence did not support an aiding and abetting theory. *Collins, supra*, 605 F.2d at 113-14. In contrast, plaintiffs' evidence in this case fully supports such a theory.

In the present case, the court of appeals declined to "address the issue whether or not an aiding and abetting approach may ever be employed under §12(2)" (App. 14a, footnote omitted). Instead, it imposed §12(2) liability under the "proximate cause" theory. Nonetheless, the facts of this case fully support a finding of liability under §12(2) against AFS as an aider-abettor. The Third Circuit's holding in *Collins v. Signetics Corp., supra*, does not dictate otherwise. Accordingly, there is not a direct and irreconcilable conflict between the Sixth and Third Circuits.

2. THE LANGUAGE OF §12(2) FULLY SUPPORTS THE RESULT REACHED BY THE SIXTH CIRCUIT MAJORITY.

The court of appeals held that AFS was liable under §12(2). The court reached its holding by examining the statutory term "sells." It did not examine the statutory term "offers." That term provides an additional and independent basis for supporting the court's holding.

Section 12(2) encompasses any person who "offers or sells a security." The term "offer" includes "every attempt, or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value." 15 U.S.C. §77b(3). AFS's actions in promoting DTBG fall within that definition. AFS solicited investments in DTBG. As such, AFS comes within the plain language of §12(2). *See Lawler v. Gilliam,* 569 F.2d 1283 (4th Cir. 1978) (liability under §12(1), 15 U.S.C. §77l(1), which imposes liability on any person who "offers or sells" securities in violation of the registration provisions of the Act); *Katz v. Amos Treat & Co.,* 411 F.2d 1046, 1052-53 (2d Cir. 1969) (liability under §12(1)).

Both the petitioner and the Sixth Circuit addressed the issue of §12(2) liability from an unduly restrictive reading of the statute. The clear language of the statute imposes liability on one who "offers." *See* District Court Finding of Fact (App. 31a-33a). Neither the petitioner nor the Sixth Court examined that language, or the definition of it. This Court has "repeatedly recognized that securities laws combating fraud should be construed 'not technically and restrictively, but flexibly to effectuate [their] remedial purposes.' [citations omitted]." *Herman & MacLean v. Huddleston,* 459 U.S. 375, 386-7 (1983).

AFS's participation in the sale of DTBG securities fell well within the definition of one who "offers."

The Sixth Circuit's statement that "[i]f we are limited to a literal reading of the statute, it is obvious that the plaintiffs here must fail, because Avco was not in the literal sense the 'seller' of DTBG securities" (Pet's App. 12a) is incorrect. It overlooks the imposition of §12(2) liability on any person who "offers or sells a security." AFS's activities included attempts to dispose of DTBG securities. As such, it "offered" securities within the definition of §12(2). Thus, the Sixth Circuit's conclusion as to liability is fully consistent with the statutory language.

CONCLUSION

For the foregoing reasons, the petition for writ of certiorari should be denied.

Respectfully submitted,

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MOTION FILED

JAN 4 1985

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On Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

---

MOTION OF THE AMERICAN FINANCIAL SERVICES ASSOCIATION FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE, AND BRIEF OF AMICUS CURIAE

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January 1985

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

IN THE

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---

MOTION OF THE AMERICAN FINANCIAL SERVICES ASSOCIATION FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE IN SUPPORT OF THE PETITIONER'S POSITION

To the Honorable, the Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

The American Financial Services Association (AFSA) respectfully moves, pursuant to Rule 36 of the Rules of this Court, for leave to file the attached brief as *amicus curiae* in support of Petitioner's position. The Petitioner has consented to the filing of such brief. The Respondents have denied consent.

INTEREST OF THE AMERICAN FINANCIAL SERVICES ASSOCIATION

The AFSA is the nation's largest trade association serving the consumer finance industry. Organized in 1916, AFSA represents over 530 companies engaged in the extension of consumer credit throughout the United States. Virtually every AFSA member company extends consumer credit through a system of branch offices pursuant to state regulation and licensure.

AFSA members most commonly extend consumer credit, such as loans to finance the purchase of automobiles and applicances, home improvements, debt consolidation and for educational purposes. Branch office managers are responsible for the generation of new business, the implementation of a predetermined, independently verifiable credit scoring system used to evaluate loan applications, the collection of accounts and other matters related to the operation of a consumer loan office.

The decision in this case effectively renders any indirect participant in a securities transaction—including those who merely provide the financing for the transaction—liable under § 12(2) of the Securities Act of 1933 (15 U.S.C. 77*l*(2)). The decision places the Petitioner, and other AFSA members, under a duty to inquire about the nature of securities transactions and to evaluate the safety and soundness of securities investments.

Placed under a duty to investigate the safety and soundness of securities investments and to train and communicate with branch office personnel about securities matters, consumer finance companies may financially and effectively be prohibited from offering credit for such purposes. It is these companies which provide the small loan for the "first time" or infrequent investment made by homeowners and consumers.

AFSA is therefore concerned with the resolution presented in this case. The Petitioner has argued persua-

sively that there are direct and irreconcilable conflicts between the circuits and between the court of appeals decision and decisions of this Court.

At least six circuits provide divergent views of the issue raised in this case, rendering it virtually impossible for creditors who operate nationally to either understand their liability or to effectively prevent similar cases from arising.

The confusion and uncertainty of the decisions is mirrored by the uncertainty facing lenders which suddenly discover they are liable under Securities Act provisions, which were never anticipated and which impose upon the lenders and untrained branch personnel a duty to inquire with reasonable care into the nature of the investment.

WHEREFORE, it is respectfully requested that the Court grant the American Financial Services Association leave to file the attached brief as *amicus curiae* in support of the Petitioner's position.

Respectfully submitted,

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January 1985

QUESTION PRESENTED

Whether a person who has not sold a security may be liable for the sale of that security under § 12(2) of the Securities Act of 1933?

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LEGISLATIVE HISTORY:

H.R. Rep. No. 85, 73rd Cong., 1st Sess. (1933) 6

IN THE

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OCTOBER TERM, 1984

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---

BRIEF AMICUS CURIAE OF THE AMERICAN FINANCIAL SERVICES ASSOCIATION IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

The American Financial Services Association submits this brief, as *amicus curiae* in support of the Petition for Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit filed by the Petitioner Avco Financial Services, Inc.

STATEMENT OF THE CASE

This case arose as a result of a number of transactions made by the Toledo, Ohio office of AVCO Financial Services, Inc. (AVCO). In the normal course of consumer lending, beginning in February 1971, the Toledo office made loans to individuals purchasing shares of Dare To Be Great (DTBG), a pyramid investment sale operated with evangelical zeal by its promoters. In May 1971, DTBG personnel contacted the office manager and asked him to attend one of the promotional meetings, which he

did without offering any comments. In June 1971, the manager attended a second meeting and spoke to the audience about the AVCC application process and credit criteria.

During a routine examination by AVCO's district manager in July 1971, the Toledo office was instructed to cease making any further loans for the purpose of financing DTBG shares. As of that date, 48 loans had been made for such purposes. At no time during that period did AVCO's management have any knowledge of or relationship with DTBG, nor did it authorize or train its branch managers to give securities advice.

In 1974 the saturation point of DTBG sales was reached and the pyramid collapsed. Plaintiff and others of the 48 persons with loans written by AVCO, lost their investment and sued.

The case was decided by the U.S. District Court for the Northern District of Ohio, *Davis* v. *AVCO Corporation*, 371 F.Supp. 782 (N.D. Ohio 1974), and later appealed to the Sixth Circuit Court of Appeals, *Davis* v. *AVCO Corporation*, 739 F.2d 1057 (6th Cir. 1984). The opinions below held that (1) the AVCO branch manager was not guilty of any fraudulent intent and was taken in by the DTBG hoopla, (2) neither AVCO nor its branch manager had any knowledge of the untruths or omissions perpetrated by DTBG, and (3) neither AVCO nor its branch manager is liable under § 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. § 78j(b)).

SUMMARY OF ARGUMENT

Amicus Curiae submits that the court of appeals decision in this case extends § 12(2) liability to a person who did not sell or offer a security, was not an agent of or controlled by the seller, did not act with scienter or recklessness, and was not employed or trained to deal in securities transactions. This result violates prior decisions of this Court and compounds the confusion occurring from diverse decisions by six circuits.

Amicus Curiae therefore urges this Court to grant the Petition for Writ of Certiorari in order to ultimately clarify this important point of law.

ARGUMENT

I. THERE IS DIRECT CONFLICT AND AN EXTREME DIVERGENCE AMONG THE CIRCUITS IN INTERPETING PERSONS COVERED UNDER § 12(2).

Section 12(2) of the Securities Act of 1933 provides that "any person who . . . offers or sells" a security by use of an untrue statement or omission of material fact is liable to "the person purchasing such security from him". (15 U.S.C. § 77*l*(2)).

Six circuits have interpreted the ambit of § 12(2). The Third Circuit held that the section was to be strictly construed to apply only to a claim by a purchaser against his immediate seller. *Collins* v. *Signetics Corp.*, 605 F.2d 110 (3rd Cir. 1979).

The Fourth Circuit has held that § 12(2)'s operative phrase "person who offers or sells" excludes persons who execute an unsolicted order or whose minor role in the transaction shows they have no causal connection with it. *Lawler* v. *Gilliam*, 569 F.2d 1283 (4th Cir. 1978).

The Fifth Circuit has said that it is clear that the term does not refer solely to those who pass title, *Canizaro* v. *Kohlmeyer & Co.*, 512 F.2d 484 (5th Cir. 1975), but also those persons whose offering or selling is a "substantial factor" in the purchaser's decision to buy. *Hill York Corp.* v. *American International Franchises, Inc.*, 448 F.2d 680 (5th Cir. 1971); *Pharo* v. *Smith*, 621 F.2d 656 (5th Cir. 1980).

More recently, the Fifth Circuit introduced a new "proximate cause" standard to determine whether a party is a "person who offers or sells" securities, stating, "[p]articipation in the sale of a security . . . is an im-

portant factor only as it relates to the concept of causation . . . we cannot say that the defendant's participation in this transaction proximately caused the plaintiffs' injury, or that they would not have purchased the security 'but for' his actions." *Croy* v. *Campbell*, 624 F.2d 709, 714 (5th Cir. 1980).

The Eighth Circuit has rejected both the broader participation theory followed by district courts in the Second Circuit and the Fifth Circuit's "proximate cause" test, holding "[w]e believe that one factor which ought to be considered in determining the 'sale' or 'offer to sell' issue is whether the defendant was uniquely positioned to ask relevant questions, acquire material information, or disclose his findings". *Wasson* v. *SEC*, 558 F.2d 879, 886 (8th Cir. 1977). More recently, the Eighth Circuit applied a substantial factor test in accord with the Fifth Circuit's *Pharo, supra*, decision. *Stokes* v. *Lokken*, 644 F.2d 779 (8th Cir. 1979).

The Ninth Circuit while at one time supportive of the substantial factor test in *SEC* v. *Murphy*, 626 F.2d 633 (9th Cir. 1980), returned to a privity test in *Feldman* v. *Simkins Industries, Inc.*, 679 F.2d 1299 (9th Cir. 1982).

In reaching its 2-1 opinion in this case, the court of appeals' decision adopts a new approach, which, it admits, "transcends the strict approach, is narrower than the formerly employed broad participation approach and different . . . than the aiding and abetting approach". (Petitioner's Brief for Certiorari at 15a). The court of appeals decision ennunciates a two-part test holding any person liable under § 12(2) if (1) his conduct is the "proximate cause" of the buyer's decision to purchase the security, and (2) if he is not successful in proving that he satisfied at least a five-part test of reasonable care. As dissenting Chief Judge Lively pointed out, "In my opinion, the majority has misread § 12(2) and reached the wrong result". (Petitioner's Brief for Certiorari at 24a).

The disparity between the circuits necessitates resolution by this Court. Corporations which operate nationally are severely burdened by the inconsistent application of this section causing their inability to uniformly manage any involvement in securities transactions. More importantly, the responsibilities and liabilities placed on national companies differ from jurisdiction to jurisdiction. Left untouched, the decsion of the court of appeals leaves securities professionals and those tangentially involved in securities transactions even more in doubt in the application of this law.

II. THE COURT OF APPEALS DECISION CONFLICTS WITH DECISIONS OF THIS COURT, AND VIOLATES THE PLAIN LANGUAGE OF THE STATUTE AND THE CONGRESSIONAL INTENT.

This Court has long reviewed securities laws by first analyzing the plain meaning of the statutory language. *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723 (1975); *Touche Ross & Co.* v. *Redington*, 442 U.S. 560 (1979); *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462 (1977). In this case, the majority opinion may have started with the statutory language, but quickly discarded it, stating "[i]f we are limited to a literal reading of the statute, it is obvious that the plaintiffs here must fail, because AVCO was not in the literal sense the 'seller' of DTBG securities". (Petitioner's Brief for Certiorari at 12a).

Furthermore, on several occasions this Court has also looked beyond the plain meaning of statutory language of securities laws to determine Congressional intent and held that "generalized references to the 'remedial purposes' of the securities laws 'will not justify reading a provision more broadly than its language and the statutory scheme reasonably permit.'" *Aaron* v. *SEC*, 446 U.S. 680, 695 (1980); *Touche Ross & Co.* v. *Redington*, 442 U.S. 560, 578 (1979); *SEC* v. *Sloan*, 436 U.S. 103, 116 (1978).

Here the court of appeals does not recognize the statutory scheme clearly intended by Congress in which Section 11 applies to signatories, directors, underwriters and experts; Section 12 applies to sellers; Section 15 to "controlling persons"; and Section 10(b) to "any person" as a catchall provision. This Court has noted the statutory design on many occasions. *Blue Chip, supra, Aaron, supra,* and *Ernst & Ernst* v. *Hockfelder,* 425 U.S. 185 (1976).

Following this Court's opinion in *Ernst & Ernst,* the court of appeals rightfully decided that the facts of this case did not satisfy the provisions of § 10(b) because of the branch manager's lack of knowledge of any fraud. The court then reached to the lesser burden of proof mandated under § 12(2) and found the Petitioner within the scope of "sellers" covered there. In light of the holding in *Ernst & Ernst,* it is irreconcilable that an indirect participant could be found not liable under § 10(b) because he lacked knowledge or the ability to obtain knowledge of the untruth or omission, but, on the other hand, could be found liable under § 12(2) because, without knowledge, he failed to act with reasonable care.

The result is that the court of appeals extends the standard of care required of "sellers" under § 12(2) to a new class of persons, namely lenders, lawyers and other indirect participants. Congress intended that the provisions of this section would apply to sellers in a position to know and disclose the material facts. "The committee has deemed . . . the burden of proof [of § 12] as both just and necessary, inasmuch as the knowledge of the seller as to any flaw in his selling statements . . are matters . . . to which the seller may readily testify . . ." H.R. Rep. No. 85, 73 Cong., 1st Sess. 23 (1933).

CONCLUSION

The Petition for Writ of Certiorari should be granted.

Respectfully submitted,

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